
CAE
ADVANCED
THINKING
CAE ANNUAL REPORT
FOR THE YEAR ENDED
MARCH 31, 1998


CAE AT A GLANCE

ADVANCED THINKING

> A key imperative at CAE is to provide our customers with the most advanced and innovative solutions, which create value through improving performance and efficiencies, as well as lowering costs. Ultimately, our success as a world-leading advanced technology company will be driven not by what we do today, but by what we conceive is possible tomorrow. This annual report is dedicated to our customers and employees whose advanced thinking will take CAE confidently into the future. <

ELECTRONICS GROUP	OVERVIEW
CAE Electronics Ltd. Montreal, Canada 3,750 employees	CAE Electronics Ltd. is the world leader in the des simulators and flight training devices. The compan simulation systems, power plant simulators, contro generation, transmission, and distribution.
CAE Elektronik GmbH Stolberg, Germany 540 employees	CAE Elektronik GmbH designs and produces military systems for various applications. The company also services for flight and tactical simulators. Its expe applied to European research and development pro
CAE Electronics plc Burgess Hill, U.K. 240 employees	CAE Electronics plc is comprised of two operating develops and supplies land systems simulators to a growing U.K. flight simulation and marine control capability in these key business areas.
CAE Electronics (Australia) Pty Ltd. Silverwater, Australia 110 employees	CAE Electronics (Australia) Pty Ltd. pursues opport has one operating subsidiary – CAE MRAD. Located integrated sensor stimulation products and system
CAE Electronics Inc. Leesburg, United States 35 employees	CAE Electronics Inc. is a leader in marine control s

INDUSTRIAL TECHNOLOGIES GROUP	OVERVIEW
CAE ScreenPlates Lennoxville, Canada; Varkaus, Finland 430 employees	CAE ScreenPlates is the leading global supplier of and baskets primarily for the pulp and paper indus
CAE Cleaning Technologies Cincinnati, United States 330 employees	This newly-formed group comprises CAE Ransohoff CAE Ney Ultrasonics (USA) and CAE Tempest & Dibb of advanced technology cleaning and waste minimi
CAE Vanguard Minneapolis, United States 180 employees	CAE Vanguard is the leading provider of services to the company owns the world rights to an exclusive
CAE Machinery Vancouver, Canada 120 employees	CAE Machinery, whose principal business is the ma pulp and paper industries, is the world's largest su waferboard, and other wood-based composites.
CAE Trislot Waregem, Belgium 75 employees	CAE Trislot is a leading European manufacturer of in the food and beverage, petrochemical and waste

	A FEW OF OUR CUSTOMERS
oduction of military and commercial full flight leading designer and manufacturer of visual or marine applications and electric power	Airbus Industrie, American Airlines, Delta Airlines, Edesur, Emirates Airlines, Finnair, Flight Safety Boeing Training International, Nuclearna elektrarna Krško, Royal Airforce, Royal Dutch Navy, UAE Navy
simulators, aircrew selection systems and training maintenance, repair, overhaul, and modification al-time data processing and visual systems is further	Austrian Army, Deutsches Zentrum für Luft- und Raumfahrt e.V. (German Space Agency), German Airforce, German Army, German Ministry of Defence, German Navy, NATO, Norwegian Army
AE Invertron and CAE Electronics. CAE Invertron dwide. CAE Electronics focuses its activities on the rkets and on developing a strong U.K.-based	Austrian Army, Belgian Army, British Army, Canadian Department of National Defence, Lockheed Martin Information Systems/GEC Marconi, Royal Brunei Armed Forces, UK Defence Evaluation and Research Agency, UK Royal Airforce, UK Royal Navy
oss CAE Electronics' entire product line. The company e, Australia, the company is a world leading supplier of ilitary radar testing and training markets.	Defence Science and Technology Organisation, Lockheed Martin Aeronautical Systems, Qantas Airways Limited, The Royal Australian Air Force, The Royal Australian Army, The Royal Australian Navy, Royal Canadian Air Force, Solaris Power
	Avondale Alliance, DARPA, General Dynamics Bath Iron Works Division, Raytheon Systems Company, U.S. Naval Sea Systems Command

	A FEW OF OUR CUSTOMERS
nanufactured stainless steel screen plates, cylinders,	A. Ahlstrom, Beloit Company, International Paper, Irving Paper, Jefferson Smurfit, Lamort, Sunds, Thermo Black Clawson Company, Valmet, Voith Sulzer Paper Technology
Blackstone (USA) and two recent acquisitions: AE Cleaning Technologies is a leading supplier ipment.	Allied Signal, Borg Warner Corp., Chrysler Corporation, Cummins Engine Co., Ford Motor Company, General Motors, Nippondenso, Robert Bosch Corporation, Toyota
erican railways. In addition to supplying new axles, emical deposition process for rebuilding axles.	Burlington Northern & Santa Fe Railroad, Canadian National Railroad, Canadian Pacific Railroad, CSX Corporation, GE Transportation Systems, Norfolk Southern, TTX Company, Union Pacific Railroad, VIA Rail Canada
f engineered equipment for the forest products and lakers used in the production of oriented strand board,	Abitibi-Consolidated Corporation, Avenor Inc., Georgia-Pacific Corporation, LE GROUPE FOREX INC., Louisiana-Pacific Corporation, Norbord Industries Inc., Weyerhaeuser
ed wedge wire filtering and separation products used atment industries.	BOC Process Plants, Dorr Oliver Inc., Filtrox AG, Filtrex s.r.l., Filterwerk Mann & Hummel GmbH, Nuovo Pignone (GE), Royal Dutch Shell, Skoda s.r.o.

ADVANCED THINKING

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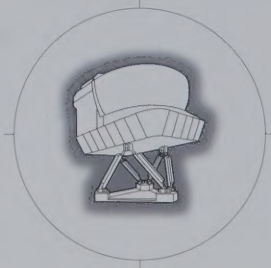
ADVANCED MILITARY SIMULATION

ED ELICH
CAE ELECTRONICS LTD.
CANADA

KAY CHADWICK
CAE ELECTRONICS PLC
UNITED KINGDOM

> "The standard practice for many of the world's air forces has been to contract for simulators from one manufacturer, maintenance from another and instructors from yet another supplier. The solution we proposed to the Royal Air Force is a totally integrated training system, the first of its kind in the world. The facility that is now under construction at RAF Benson will house six simulators for four types of medium support helicopters, with full visual, communications and tactical interactivity between any number of the simulators. The major breakthrough in training effectiveness – an innovation CAE Electronics co-developed with the customer – will be the Tactical Control Centre. The TCC is a state-of-the art, high-fidelity facility including a video wall. From the TCC, observers and instructors can direct, monitor and role-play in complex tactical environment simulations in conjunction with the aircrews inside the simulators. This has never been done before. As difficult as it is to achieve, it will be a significant advance in the quality of the RAF's training."



PUMA HC MK.1
HELICOPTER SIMULATOR

> CAE WAS AWARDED THE CONTRACT TO BUILD AND OPERATE AN ADVANCED TRAINING FACILITY FOR THE U.K. MINISTRY OF DEFENCE. THE $900 MILLION CONTRACT IS THE LARGEST IN CAE'S HISTORY AND SOLIDIFIES THE COMPANY'S LEADERSHIP POSITION IN MILITARY FLIGHT SIMULATION.

> CAE AND ITS PARTNERS, THROUGH A NUMBER OF INTERNATIONAL BANKS, WILL FINANCE THE RAF'S NEW TRAINING FACILITY AND OPERATE IT OVER AN INITIAL PERIOD OF 20 YEARS. THIS PRIVATE FINANCE INITIATIVE GUARANTEES FIXED COSTS FOR THE RAF AS WELL AS OPTIMUM UTILIZATION OF THEIR EQUIPMENT.

U.K. MINISTRY OF DEFENCE

WING COMMANDER RICHARD EASTMENT

"Prior to the delivery of the RAF's new Merlin Mk 3 helicopters, we conducted a complete training needs analysis. The study showed that there were substantial areas of operational training that could be better conducted in simulators. Out of that need, and the RAF's desire for a cost-effective, high-quality facility, we developed the requirement for an integrated training centre. From my training perspective, however, the core of the facility being developed by the CAE Electronics consortium is not the simulators and computer-based training per se. It is the ability to have all six simulators 'fly' together in the same visual-sensory representation that makes this the most exciting simulation project we've ever had. This gives us the capability to run multi-aircraft exercises as well as rehearse for actual combat missions. In other words, CAE's solution will transform our simulators from simple skills trainers into true operational training devices. It's probably the most advanced, interactive simulation training system in the world today." <

ADVANCED PULP SCREENING TECHNOLOGY

FRANK AALTONEN
CAE SCREENPLATES
FINLAND

JARI JURVANEN
CAE SCREENPLATES
FINLAND

> "Ensuring fibre quality in the papermaking process is the job of the screen plate. The headbox screen plate is the last in the process before pulp is made into paper – it allows only the right size of fibres to pass through its slots. Trying to optimize the milling of these slots led us to study in real detail the workings of the screen plate. We came to the conclusion that while the surface is important, it was imperfect slots that caused quality problems. Traditional slot cutting techniques were not working, so we adapted our existing water jet cutting process. Right away we achieved two things: high open area, which means high capacity; and a very smooth slot surface, which means better paper quality. Today, we are the only manufacturer in the world to have perfected this process for fine screen plates, and that is why we were certain our new 'CAE SuperFlow™ Headbox Quality' screen plate could solve SCA Laakirchen's quality problems."

CAE SCREENPLATES'
WATER JET CUTTING EQUIPMENT

FOR A PAPERMAKING MACHINE TO RUN AT OPTIMUM CAPACITY AND QUALITY, THE FINAL SCREEN PLATE MUST HAVE A VERY SMOOTH SURFACE. CAE SUPERFLOW™ HEADBOX QUALITY SCREEN PLATES ACHIEVE THAT SURFACE QUALITY WITH AN INNOVATIVE WATER JET CUTTING PROCESS.

BY RETHINKING THEIR PROCESSES, ENGINEERS AT CAE SCREENPLATES SIGNIFICANTLY IMPROVED BOTH THE SLOT AND SURFACE QUALITY OF HEADBOX SCREEN PLATES. BUILDERS OF PAPERMAKING MACHINES ARE RECOGNIZING THE BENEFITS OF THESE INNOVATIONS.

SCA LAAKIRCHEN

GERHARD GRUSSOVAR

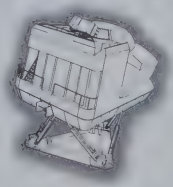
"We recently completed a rebuild of one of our papermaking machines to improve the quality of the sheet. It was still not running to our satisfaction, and most of the experts we consulted suggested we needed to replace a major component called the 'selectifier.' Only CAE ScreenPlates recommended changing the headbox screen plate to achieve better process and quality. They said this action would also correct the apparent selectifier problem. We tried a competitive screen plate but were not pleased with the results. After installing the 'CAE SuperFlow™ Headbox Quality' product, however, we have had no problems with either the screen plate or the selectifier. In fact, we have increased the throughput of the machine and have achieved a substantial reduction in the variations of the paper sheet. We now have what I call 'super quality' and much less downtime. So we are very satisfied with how CAE ScreenPlates helped us think through and resolve this problem." <

ADVANCED FLIGHT SIMULATION

MICHEL MOREL
CAE ELECTRONICS
CANADA

MARC-ANDRÉ TALBOT
CAE ELECTRONICS
CANADA

> "Hardware and software in a flight simulator must match the corresponding flight deck and engine type of the actual aircraft. Downtime is costly on this equipment, and 30 to 40 minutes are typically required to set up different cockpit/engine configurations. Swissair asked us to reduce the time to 10 to 15 minutes. We had to develop innovative mechanical and electrical solutions for switching from, for example, an A330 cockpit to an A340 cockpit. We also needed a faster way of switching over the flight management system software, or OBRM. And because on Airbus simulators we are using real aircraft computers, switching between simulation for three possible engine types for the A330 and the single engine setup of the A340 cockpit is quite complex. It required us to rethink the entire process of physically changing the 14 OBRM cartridges in the flight management computers every time we were reconfiguring the simulator. The solution we arrived at gives Swissair the ability to software-select between four different aircraft configurations, all on a single "super OBRM" cartridge. We expect our solution to become the industry standard on commercial simulators."



AIRBUS A340 FULL FLIGHT SIMULATOR
WITH MAXVUE™


swissair

SWISSAIR

CAPTAIN HANS FREI

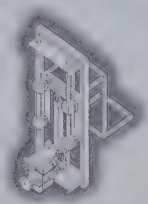
"We were concerned at Swissair about the cost of reconfiguring the simulator for the three different engine types of the A330 as well as the A340. Our idea was to keep the change of equipment as simple as possible for two reasons: we wanted to reduce the time required to change equipment and also to minimize the wear and tear, particularly on the flight management system OBRMs. CAE Electronics analyzed the problem and the technical solution they proposed, which is the software of the four OBRMs enclosed on a single 'super OBRM,' is an excellent one for Swissair. Reconfiguring the simulator cockpit will be much faster, especially between A330 engine types, where now no hardware reconfiguration is involved. Maintenance procedures will also be easier with a single super OBRM cartridge rather than four. We expect the super OBRM will be a very cost-effective solution for us." <

ADVANCED ULTRASONIC CLEANING

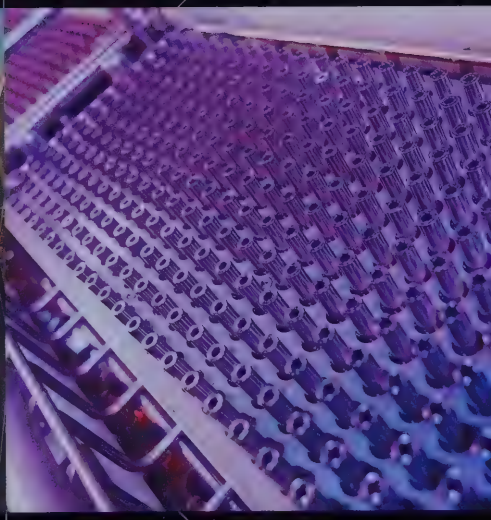
ALEX BELSKI
CAE BLACKSTONE
U.S.A.

JAY NAWANI
CAE BLACKSTONE
U.S.A.

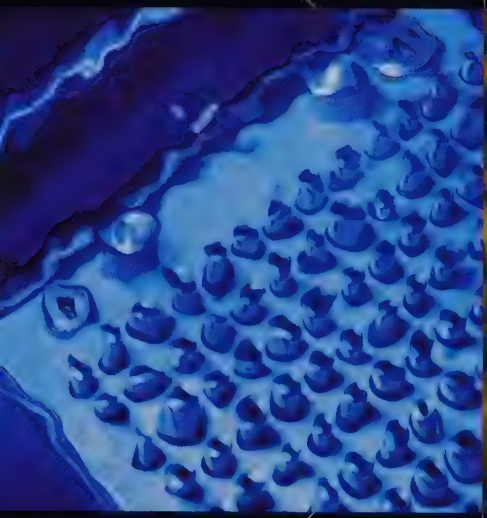
> "Our customer, Autocam, is known for using innovative manufacturing processes to produce high-precision parts for the automotive, medical and electronics industries. Critical parts for equipment such as anti-lock brakes or fuel-injection systems must be very clean before they can be used, and this was where Autocam was running into problems with quality and reliability of their existing equipment. The challenge they put to CAE Blackstone was a stringent specification for cleanliness and reliability. We co-developed the equipment with them in our shop, beginning with innovative 'smart' features to enhance reliability. We incorporated our immersible ultrasonic transducers, combining ultrasonics with mechanical agitation in numerous configurations. Ultimately, we developed a customized machine that gives Autocam the right combination of quality, throughput, reliability and cost for their operating environment. This machine is now running 20 hours a day, seven days a week, and is virtually maintenance-free. Based on this experience, CAE Blackstone is now Autocam's preferred supplier of ultrasonic cleaning systems."



AGITATION DEVICE COMPLEMENTING
AN ULTRASONIC CLEANING SYSTEM



FOR AUTOCAM, CAE BLACKSTONE COMBINED ULTRASONIC TRANSDUCERS WITH STANDARD IMMERSION CLEANING TO DELIVER EXCEPTIONALLY CLEAN PARTS AND EXCEPTIONALLY RELIABLE OPERATION. MAINTENANCE AND OPERATING COSTS ARE GREATLY REDUCED.



THE MACHINE DESIGNED AND MANUFACTURED BY CAE BLACKSTONE MEETS THE TIGHT CLEANLINESS SPECIFICATIONS DEMANDED BY THE AUTOMOTIVE PARTS INDUSTRY. THE EQUIPMENT IS OPERATING AT FULL PRODUCTION CAPACITY, ACHIEVING CONSISTENTLY EXCELLENT RESULTS.

AUTOCAM

MINGDE WANG

"We faced two problems with our previous cleaning machines at Autocam. The first was their inability to produce parts that were clean enough for some of our customers. The second was that the machines were very maintenance-intensive. Those two problems made it difficult for us to meet our commitments to customers for quality and quantity. We pushed CAE Blackstone with the original specification, because we were being pushed by our customer to achieve almost impossible standards. They responded very well. Their people improved on the written specification by continually coming up with ideas on how to make the equipment more reliable or produce higher-quality parts. To that kind of cooperative thinking, we added cutting-edge technologies like CAE Blackstone's immersible ultrasonic transducers. They also made further technical and conceptual adjustments during the trial runs. As a result, the CAE Blackstone machine is exceeding our expectations not only for performance and maintenance, but also cost of ownership." <

ADVANCED MILITARY SIMULATION

PAUL HOFFMAN
CAE ELEKTRONIK GMBH
GERMANY

EBERHARD RIEDEL
CAE ELEKTRONIK GMBH
GERMANY

> "The requirement specification of the German Army Aviation School for the Night Time low level Flight program (NTF) is one of the most challenging we have ever seen. For example, we have to design a new hardware platform that also accepts modular components. Any cockpit module in the program must be capable of being rolled on and rolled off any simulator motion base. We were given a maximum time of only two hours for a complete changeover. That includes all cables, the software, rolling out the instructor station and cockpit, and then rolling in and reconnecting a different configuration. The software, written in Ada programming language, is also new. The customer requires a generic software model for the simulators covering several helicopter types. That is then driven by task-specific data so the simulator works like a particular helicopter. The complexity of this project is demanding that we rethink almost everything we have done in the past."

CH 53
HELICOPTER SIMULATOR

GERMAN ARMY AVIATION SCHOOL

BRIGADIER-GENERAL FRITZ GARBEN

"Our objective is to realize a very promising basic training concept, which is based on the close interconnection of simulator hours and real flight hours. The challenge to CAE is very great in this new program. The simulators must realistically simulate helicopter flight in all phases, at all speeds and over any terrain. They must perform equally well under visual, instrument and night-vision conditions. In addition, they must be freely programmable and interactive to represent defined missions. So this is a complex project, but we know of CAE's intensive commitment. We are very involved with their specialists in every step of the program in order to ensure that our expectations are met. We have had years of positive experiences with CAE's CH 53 and UH 1D simulators, and we are confident the solutions they are developing for German Army Aviation in this major new project will validate these experiences." <

FIVE IMPERATIVES WILL DRIVE CAE COMPANIES: CREATION OF SHAREHOLDER VALUE, LEADERSHIP, FOCUS ON CUSTOMERS,

A COMMITMENT TO INNOVATION AND TECHNOLOGY, AND CREATING A MOTIVATING AND CHALLENGING ENVIRONMENT FOR EMPLOYEES.

> As measured by five fundamental imperatives, fiscal 1998 was a record year for CAE.

Through improved financial and operational performance and optimization of assets, CAE created more *shareholder value.* For the year, revenue grew by 6 percent, net earnings increased by 16 percent and our order backlog almost doubled. We also received a fair price on the sale of CAE Aviation, a business which no longer fit with our strategic direction. Our *focus on customers* resulted in securing long-term agreements with American Airlines, Delta Airlines and the U.K. Ministry of Defence. The commitment to *innovation and technology* drove our investment in new ultrasonic technologies, the launch of the MAXVUE Plus™ visual simulation system and the introduction of the new MacroFlow™ screening technology for the pulp and paper industry. CAE further strengthened its *leadership* in world markets by capturing nearly 90 percent of the buoyant market for commercial simulators and, for the first time, we attained world leadership in military flight simulation. Our people tell us we continue to progress in *creating a motivating and challenging environment* for all CAE employees.

We are challenged and excited about the notion of *advanced thinking,* the theme of this year's annual report. While we are proud of our accomplishments in fiscal 1998, we believe doing more of the same in the future simply will not be enough.

As a world leading advanced technology company, our task is to remain at the forefront of technology. To achieve this, we will follow a strategy of continuous renewal, harvesting the value from existing technologies as they mature and re-investing in new and emerging opportunities.

Investments in technologies will not be done in isolation. Our focus will be to build CAE around core markets and well-defined core capabilities. One example is our strategy to achieve leadership in cleaning technologies. We entered the market through the acquisition of CAE Ransohoff in 1995. Since then, we have expanded through further investments in ultrasonic technologies and established an entry position in the European market. From this single operation with revenue of US$24 million in 1995, we formed CAE Cleaning Technologies and expect to more than quadruple its size by the end of this century. We are well along the road to building world leadership in cleaning equipment and waste minimization serving automotive and industrial customers. We have similar strategies for our other core businesses.

In addition to the need to continually revitalize the Company's performance with new and advanced technologies, we have the additional task of encouraging new and advanced thinking. We continue to explore investments in emerging technologies that may lay outside our core businesses, but fit within our capabilities. We also encourage CAE employees to advance their own thinking beyond what we do today to what could be done tomorrow to better serve customers.

We are both challenged and energized to take CAE to a new level of performance, leadership and value creation.

John E. Caldwell

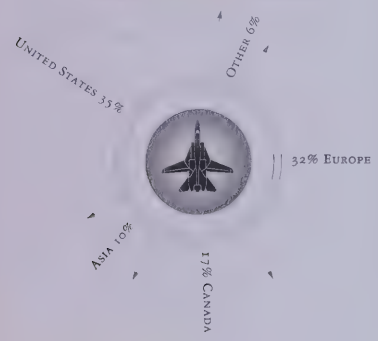
President and Chief Executive Officer

FINANCIAL REVIEW

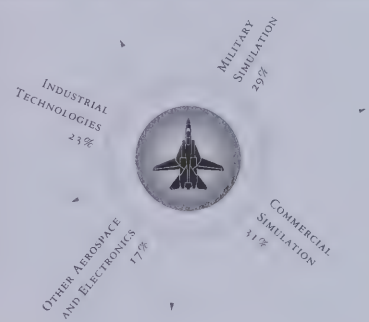
FINANCIAL HIGHLIGHTS

(Amounts in thousands except per share amounts)	1998	1997
OPERATING RESULTS		
Revenue	$ 922,369	$ 867,344
Net earnings	$ 70,236	$ 60,276
FINANCIAL POSITION		
Total assets	$ 928,179	$ 698,761
Total debt, net of cash	$ 68,116	$ 135,696
PER SHARE		
Net earnings	$ 0.64	$ 0.55
Dividends	$ 0.16	$ 0.16
Shareholders' equity	$ 2.50	$ 2.08

GEOGRAPHIC DISTRIBUTION OF REVENUE



REVENUE BY PRODUCT LINE



REVENUE

(millions of dollars)

Consolidated revenue rose six percent in fiscal 1998 due to higher commercial simulation sales and strong performance from CAE Cleaning Technologies.

98	922
97	867
96	810
95	658
94	591

EARNINGS FROM CONTINUING OPERATIONS

(millions of dollars)

Consolidated net earnings in fiscal 1998 increased 16 percent largely due to higher revenue and included the net positive effects of several non-recurring transactions.

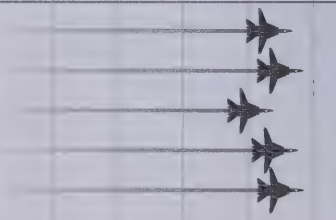
98	70
97	60
96	59
95	47
94	35

RESEARCH AND DEVELOPMENT SPENDING

(millions of dollars)

CAE remains strongly committed to research and development, investing an average of 13 percent of revenue over the past five years.

98	97
97	101
96	90
95	99
94	101

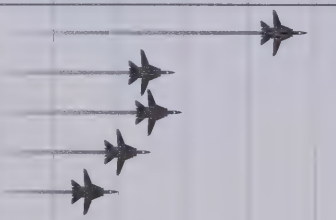


BACKLOG

(millions of dollars)

Order backlog rose to a record $1.7 billion in fiscal 1998 due to the inclusion of the $900 million MSH program and numerous commercial simulator orders.

98	1,702
97	890
96	931
95	740
94	536



SUMMARY OF CONSOLIDATED RESULTS

Revenue

Consolidated revenue for fiscal 1998 rose six percent to $922.4 million, from $867.3 million in fiscal 1997. The increase in revenue stemmed from the buoyant commercial simulation market and CAE's success in capturing 87 percent of the units sold worldwide, and the strong performance of the group of companies newly named CAE Cleaning Technologies, formerly referred to as CAE Ransohoff.

Net Earnings

Consolidated net earnings reached record levels in fiscal 1998: $70.2 million or $0.64 per share compared with net earnings of $60.3 million or $0.55 per share in fiscal 1997. The 16 percent increase was commensurate with the higher revenue and included a pre-tax gain of $6.0 million from several non-recurring transactions. Gains were realized on the disposition of CAE Aviation and the foreign currency translation related to the reorganization of the Company's European structure. These more than offset the costs associated with the North American manufacturing consolidation at CAE ScreenPlates, the reorganization of CAE Electronics Ltd. along product lines and the exiting of under-performing product lines, as well as the writedown of the carrying value of CAE's Swedish screen plate subsidiary.

NON-RECURRING TRANSACTIONS

Disposition of CAE Aviation

CAE Aviation, a leading aircraft service company principally for the Canadian government, no longer fit CAE's long-term strategic direction to focus on world-leading advanced technology businesses. On January 28, 1998, the Company completed the sale of substantially all the assets and operations of CAE Aviation. Proceeds from the disposition include $57.5 million cash received on closing. A further $9.7 million is receivable from the purchaser, representing the increase in net assets from the date the transaction was valued to the closing date. In addition, the purchase price is subject to further increases contingent upon the future award of a specific contract, the outcome of which is currently uncertain. The resulting gain on sale totaled $19 million.

Foreign Currency Translation

The Company reorganized its European wholly-owned subsidiaries. As a result of the reorganization, a $7.5 million gain from currency translation adjustments, previously deferred as part of Shareholders' Equity, was realized.

Reorganization and Rationalization of Certain Product Lines

During fiscal 1998, CAE Electronics Ltd. was reorganized along four product lines – Commercial Simulation and Visual Systems, Military Simulation and Training, Energy Control Systems and Marine Control Systems. As part of the reorganization, after careful review of future opportunities and the likelihood of achieving acceptable financial returns, the company decided to discontinue its activities in certain product lines. Total costs of $13.3 million have been incurred or provided with respect to the reorganization and the discontinuation of these product lines, representing expenditures made during the year, and the writedown of related assets to their net realizable value.

Consolidation of North American Screen Plate Manufacturing

In September 1997, the Company announced CAE ScreenPlates North America would consolidate its Glens Falls, New York, manufacturing operations into its Lennoxville, Quebec, facility. This consolidation was successfully completed within 60 days of its announcement, resulting in a one-time cost of $4.5 million for employee terminations and the writedown of assets to net realizable value. CAE ScreenPlates realized substantial cost savings in the fourth quarter of fiscal 1998 arising from the consolidation.

Writedown of Investment in Certain Subsidiaries

As at March 31, 1998, the Company determined that there had been an impairment in the carrying value of its Swedish screen plate subsidiary as a result of changing market conditions. Accordingly, the Company wrote down its investment by $2.7 million.

Cash Flow

Cash balances increased by $179 million compared with an increase of $9.7 million in fiscal 1997. The higher cash balance included the impact of increases in long-term borrowings of $118.2 million in fiscal 1998 and $133.4 million in fiscal 1997. The improvement in cash flow also resulted from proceeds received on the disposition of CAE Aviation and lower non-cash working capital. The latter was due to a significant increase in deposits on contracts related to the timing of payments on both commercial and military simulation programs. These more than offset increased capital expenditures to support facilities expansion, commercial simulator builds for long-term leases and acquisitions.

Backlog

Order backlog rose to a record $1.7 billion compared with $890 million at March 31, 1997. The significant increase in backlog reflects higher commercial simulation orders and the inclusion of the $900 million U.K. Medium Support Helicopter (MSH) military simulation program. Revenue on this latter program is expected to be realized over 20 years: 25 percent during the simulator-build phase over the next three years and the balance equally over the remaining life of the contract.

ELECTRONICS GROUP

The Electronics Group consists of five strategically located operations – CAE Electronics Ltd. (Canada), CAE Elektronik GmbH (Germany), CAE Electronics plc (United Kingdom), CAE Electronics Inc. (United States) and CAE Electronics (Australia) Pty Ltd. The Group is the world's leading supplier of commercial and military flight simulators and visual systems and also supplies a variety of other military simulation and training systems, real-time energy control systems and marine control systems.

FINANCIAL RESULTS

(Figures in thousands)	1998	1997	1996	1995	1994
ELECTRONICS GROUP					
Revenue	$ 715,272	656,310	620,972	523,257	480,983
Operating Earnings	$ 74,384	57,790	53,115	42,124	34,892
Backlog	$ 1,624,411	787,407	831,022	657,665	493,515
Capital Expenditures, net	$ 57,431	29,856	24,401	15,027	10,702

The financial performance of the Electronics Group improved for the fifth consecutive year. The nine percent growth in revenue was due to higher commercial simulation activity. Not only was the market buoyant, particularly in North America, but CAE was successful in further increasing its market share.

Operating earnings rose 29 percent due to growth in revenue and margin improvements in the commercial simulator product line and the exiting of certain product lines.

The increase in backlog reflects CAE's continued high rate of awards in the buoyant commercial simulation marketplace as well as the award of the 20-year MSH program.

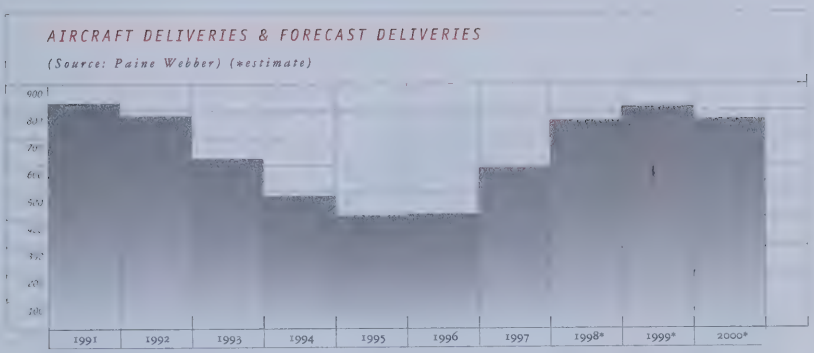
Capital expenditures also increased as CAE Electronics plc. commenced construction of a new 60,000 square-foot facility in Burgess Hill, U.K. to support increased activity. Included in capital expenditures are four commercial full flight simulators and visual systems that have been leased to customers.

OPERATIONAL HIGHLIGHTS BY PRODUCT LINE

COMMERCIAL FLIGHT SIMULATION

Fiscal 1998 was exceptional for commercial simulator orders. A total of 67 orders were placed, more than triple the annual average over the last five years. Contracts awarded this year were only exceeded in 1990, when 71 orders were placed. This growth is a reflection of ongoing fleet renewal, particularly in North America, and the effect of increased air passenger miles.

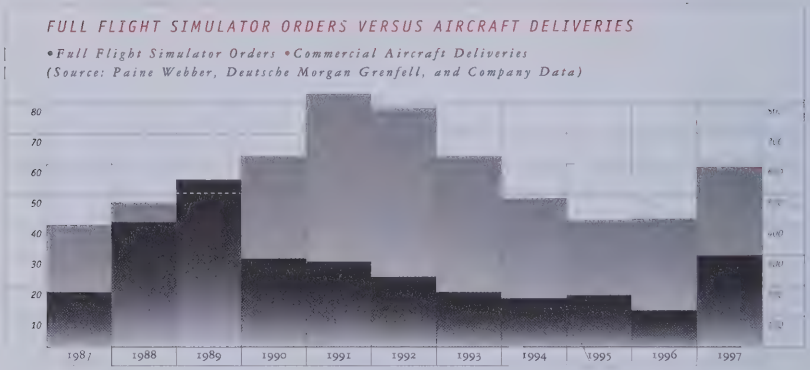
CAE Electronics Ltd. won 38 of the 47 full flight simulators ordered and all 20 of the flight training devices, representing an 87 percent market share. Part of CAE's success is attributable to the company's decision to pre-build a number of simulators to shorten delivery time in anticipation of the increase in demand. In addition to these contract awards, CAE was successful in establishing long-term supply agreements with American Airlines and Delta Airlines for future simulation needs.



Aircraft deliveries are expected to increase over the next few years due to fleet renewals, annual growth in air traffic of approximately 5% and the generally strong financial position of the airline industry.

Major orders received were as follows:

- Airbus Industrie, a first-time customer, for one Airbus A320 full flight simulator;
- Air Canada for one Airbus A340 full flight simulator and one Canadair Regional Jet full flight simulator;
- Air China for one Boeing 777-200 full flight simulator, one Boeing 737-800 full flight simulator, and one Boeing 777-200 flight training device;
- American Airlines, as a preferred supplier, with an immediate order for two Boeing 737-800 full flight simulators, one Boeing 777-200 full flight simulator, one Boeing 767-300 full flight simulator and one Embraer EMB-145 full flight simulator;
- Boeing's Douglas Products Division for a Boeing 717-200 (formerly designated the MD-95) full flight simulator;
- Continental Airlines for one Boeing 777-200 full flight simulator and flight training device and one Boeing 737 next generation full flight simulator and flight training device;
- Delta Airlines, as a preferred supplier, for one Boeing 737-200 full flight simulator, one Boeing 737-600/700/800 full flight simulator, two Boeing 767-300/400 full flight simulators, one Boeing 777-200 full flight simulator and ten flight training devices for similar Boeing aircraft;
- Federal Express Corporation for two MD-10 and one MD-11 fixed-base simulators;
- Flight Safety/Boeing Training International for a Boeing 737-700 full flight simulator and a Boeing 737-600/700/800 flight training device;
- United Airlines for two Boeing 747-400 full flight simulators, one Boeing 757-200 full flight simulator and two Boeing 757-200 flight training devices.



As pilots must be trained prior to delivery of actual aircraft, there is a close relationship between simulator sales and aircraft deliveries.

CAE also enjoyed continued success with its MAXVUE™ visual systems. Last year, the company introduced MAXVUE Plus™, which was developed using input from the flight training community as well as technology advancements to provide enhanced realism. MAXVUE Plus™ reinforces CAE's commitment to offer state-of-the-art performance to new customers while providing a modular upgrade path for existing customers. In fiscal 1998, CAE captured 20 of 49 visual system orders, representing a 41 percent market share.

Outlook

Commercial simulator orders are driven by a number of factors including growth in aircraft fleets, changes in aircraft mix, regulatory changes in training requirements and pilot attrition. In addition, the use of simulators for training has continued to increase due to improving technology and the significant cost savings as compared to real flight time training.

These factors, combined with the predicted growth in air travel, the generally strong financial position of the airline industry, and the order backlog for delivery of new aircraft are expected to lead to substantial orders over the next few years. Order intake, however, is unlikely to achieve the same level as fiscal 1998. CAE expects to maintain its commanding leadership position due to its long-standing customer relationships and the quality, reliability, efficiency and cost of its products.

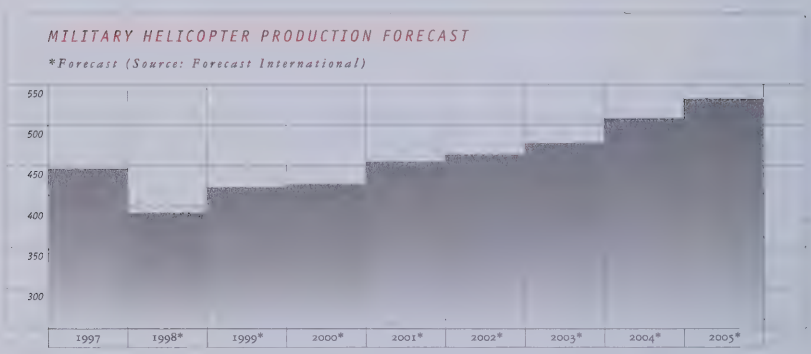
MILITARY SIMULATION SYSTEMS

In March 1997, CAE announced it had been selected by the U.K. Ministry of Defence (MoD) for the Medium Support Helicopter program, the largest program in CAE's history. The contract was signed in October 1997 and solidifies the company's world leadership position in military flight simulation. The MSH program launches CAE into the military training services sector, a new business for CAE. Together with its consortium partners, CAE will build, own, and operate a new facility at RAF Benson in Oxfordshire and provide the Royal Air Force with training services. Training in this facility will be provided over an initial period of 20 years with six helicopter simulators: two Chinook Mk2 and one Chinook Mk3, two Merlin Mk3 and one Puma helicopter simulator.

It will also include a state-of-the-art Tactical Control Center and associated high-fidelity synthetic ground school equipment and computer-based systems to train aircrews. This program will provide CAE with approximately $900 million of revenue over the next 20 years; 25 percent will be realized in the first three years during the simulator build and the balance equally over the remaining term of the contract. Financing for this program will be provided by three financial institutions as well as equity capital from CAE and the other consortium partners.

CAE Elektronik GmbH continues to lead the way in the German market with the award of its eighth Tornado full mission simulator order. The unit will be delivered to the German Air Force Base at Holloman Air Force in New Mexico. This simulator will be used both for biennial tactical training and extended top-grade training. During the year, operations focused on the completion of the Tornado computer upgrade and the initial development phases for the $226 million Night Time low level Flight (NTF) helicopter contract. This contract calls for CAE to design, develop and manufacture four full flight simulators, two for the UH-1D helicopter and two for the CH-53 helicopter, and eight primary training devices for the EC-135, the primary training helicopter for the German Army Aviation School in Bückeburg, Germany.

Both CAE Electronics plc and CAE Elektronik continued to successfully provide land-based combat simulation training systems. In Germany, the company was awarded a program to upgrade the combat simulation system SIRA-Battalion that will allow both the brigade and battalion commanders to train in the field. The main activities at CAE Electronics plc focused on the Warrior Observation Post Vehicle program this year. This $36 million contract, which was awarded in January 1997, positions CAE as a significant supplier of sophisticated artillery and gunnery training solutions. It is the company's



The introduction of new rotorcraft will result in gradual growth in the market for military medium/heavy helicopters. This will result in many simulator sales opportunities for CAE around the world.

largest program ever. Recently CAE Electronics plc was selected by Lockheed Martin to develop and supply radio communications network systems and mock battlefield vehicles for the British Army's combined arms tactical trainer.

In the last two years, CAE Electronics plc doubled in terms of revenue and number of employees. Prospects for the next several years are equally positive. To support this pace of growth, in October, 1997, the company started construction of a new two-story 60,000 square-foot facility with a potential for future expansion to 100,000 square feet. The new building is expected to be ready for occupancy in the fall of 1998.

During the year, CAE further solidified its relation with Agusta Spa. The two companies teamed for an Agusta-Bell 205 helicopter simulator upgrade and modernization for the Italian army. Together with others, they are also members of the Team Cormorant consortium which has been selected by the Government of Canada to provide 15 search and rescue helicopters. CAE will provide any necessary training equipment.

The CF-18 System Engineering Support Contract with Bombardier Inc. continues for the 11th year to showcase knowledged base life cycle support concepts using data management, integrated logistic support, and embedded systems engineering to drive system changes for the aircraft.

Outlook

The military simulation and training market is driven by the introduction of new aircraft, upgrades and life extensions to existing aircraft and a shift to greater use of simulation in pilot training programs due to the high degree of realism and the significantly lower cost. In addition to technology and price, the customers' – in most cases governments – key purchase criteria include the contractor's local presence and ability to deliver, finance, maintain and operate a turnkey training center. CAE is well positioned to capitalize on opportunities in the international market, with operations in Canada, the United States, Germany, the United Kingdom, and Australia, as well as teaming arrangements in other countries.

CAE will capitalize on its leadership position in the worldwide marketplace when bidding on new contracts. Over the next few years, the procurement of helicopters is expected to increase. This growth will translate into many simulation opportunities for CAE to pursue worldwide. Upcoming program bids include the Eurofighter 2000, the next generation tactical fighter for the United Kingdom, Germany, Italy and Spain; the Tornado simulator upgrade program for the U.K., which is expected to be awarded in calendar year 1998; and helicopter programs for the NH-90 for Germany, France, Italy, and The Netherlands; and the Tiger program, a joint French-German initiative.

MARINE CONTROL SYSTEMS

CAE remained the automation supplier of choice for the world's navies, with successes of past years built on the initial technology development for the Canadian Patrol Frigate program. CAE has currently delivered or is in the process of delivering control systems for 15 classes of ships for 10 navies worldwide.

CAE was on the team selected to build the U.S. Navy's next-generation amphibious assault ship, the LPD-17. CAE is providing the engineering control system used to control the ship's propulsion, auxiliary, electrical and damage control systems. The initial contract for US$15.5 million is for the first of three ships. Two follow-on options are expected for an additional nine ships.

CAE Elektronik was awarded a $20 million contract to manufacture and deliver three Integrated Platform Management systems for a new German Navy Frigate, the F124. The system will provide comprehensive damage control and onboard training systems and reduce running and maintenance costs.

The company was also selected for the Dutch LCF Frigate program to provide the Integrated Platform Management Systems, the damage control and training systems for these ships.

Another activity within this product segment is the design and manufacture of power plant simulators and the provision of power plant simulator software upgrades. In March 1998, the company was awarded seven contracts for software upgrades from a host of North American power utilities. One of the key selling points for CAE was its ability to deliver software that could run on either Windows NT or UNIX operating systems. Also in March, CAE was awarded a contract to supply a full scope real-time nuclear power plant simulator and an engineering simulator for Slovenia. This is one of the most complex full scope simulators awarded this decade. CAE's success was attributable to its leading-edge technology based on its proprietary software, ROSE™.

Outlook

CAE's marine control systems are suitable for both new ships and retrofit programs to modernize existing fleets. Significant upcoming programs are: The Royal Malaysian Navy's patrol vessel program to build 26 ships, the ASTUTE nuclear submarine program for the Royal Navy in the U.K. and the 20-ship project HORIZON for the French, Italian and the Royal navies. In the U.S. market, a significant upcoming program is the CG-47 Backfit program for the U.S. Navy. The program will retrofit 26 ships. CAE's portion is valued at US$75 million. CAE has teamed with Raytheon, its partner on the LPD-17 program, on this proposal. Contract award is expected during calendar year 1998. Other important out year programs in the U.S. are the aircraft carrier control system for the CVN 77 and CVX; the U.S. Coast Guard Deep Water project for control systems for 25 ships; and the DD-21 program for control systems for 30 ships. With its leading-edge technology, installed base, and diverse geographical presence, CAE is well positioned to maintain its market position.

ENERGY CONTROL SYSTEMS

Fiscal 1998 was spent fulfilling commitments created with the success of CAE's open architecture energy control system. The company focused its activities on new enhancements to the key technology. In the last quarter of fiscal 1998, CAE was awarded a contract from Edesur, a power utility in Argentina, for the supply of a high-voltage transmission Supervisory Control and Data Acquisition system. The system will be used to manage power to over 2 million customers in the southern sectors of Buenos Aires. CAE was also selected by ESPOON SÄHKÖ OYJ of Finland, an electricity distribution utility, for the supply of a new Distribution Management System. This system will assist ESPOON in the operation of its

Rising demand for electrical power is an important driver of sales of CAE's energy control systems. While significant opportunities exist in the Asia-Pacific region, these may be postponed pending resumption of the area's economic growth.

power network. In early calendar 1998, CAE signed a contract with Henan Provincial Power Bureau of China for the supply of an energy management system. This system will be the eighth energy control system CAE will have supplied to China.

Outlook

Two independent market drivers affect CAE's energy control systems business. The first factor is increasing demand for electrical power, which is occurring primarily in Asia. The significant opportunities in the Asia-Pacific region could be tempered following the region's recent economic crisis.

The second factor is deregulation. As the energy market is restructured, there will be an increasing demand for energy and distribution management systems. Deregulation was first initiated in the U.K., followed by Australia and the northern European countries. CAE's success in Australia and Finland position the company very well for the next large market to undergo deregulation: North America. This market is expected to grow over the next few years. The company's open architecture, leading-edge technology solution and advanced applications have placed CAE at the forefront of its competitors in the new deregulated market.

INDUSTRIAL TECHNOLOGIES GROUP

The five businesses of CAE's Industrial Technologies Group develop and manufacture advanced technology products for industrial applications worldwide. CAE Cleaning Technologies is North America's leading designer and supplier of advanced technology cleaning and associated waste minimization equipment; CAE Machinery is the leading manufacturer of proprietary machinery for oriented strand board (OSB) producers, and of debarkers for the forest products industry; CAE ScreenPlates is the world's leading supplier of precision stainless steel screen cylinders and plates – nearly half of which incorporate patented technology – for the pulp and paper industry; CAE Trislot designs and manufactures wedge wire products for the food, beverage, petrochemical and waste water treatment industries; and CAE Vanguard is the world's leading provider of railway axle reconditioning services.

FINANCIAL RESULTS

(Figures in thousands)		1998	1997	1996	1995	1994
INDUSTRIAL TECHNOLOGIES GROUP						
Revenue	$	207,097	211,034	188,831	134,335	110,164
Operating Earnings	$	24,712	28,046	31,928	22,568	15,370
Backlog	$	77,245	102,516	100,136	82,831	42,032
Capital Expenditures, net	$	9,042	16,699	7,401	7,021	3,390

Revenue in the Industrial Technologies Group declined 2 percent in fiscal 1998 compared with the previous year. The decline was attributable to soft market conditions in the pulp and paper industry and lower demand for capital equipment for the production of oriented strand board, affecting revenue at both CAE ScreenPlates and CAE Machinery. This was partially offset by higher revenue at CAE Cleaning Technologies due to the benefits of major automotive programs awarded in the latter part of fiscal 1997; a full year's results from CAE Blackstone, which was acquired in January 1997, and the one month contributions from the acquisitions of Tempest & Dibb (U.K.) and Ney Ultrasonics (U.S.A.) in February 1998. Despite weak market conditions in certain market segments, the Group continued to invest in strategic areas to further strengthen its market leadership.

Overall, weaker markets for CAE ScreenPlates and CAE Machinery resulted in lower earnings from the Industrial Technologies Group.

CAE SCREENPLATES

Operational Highlights

Throughout fiscal 1998, the expected recovery in pulp prices did not materialize. This, combined with the financial crisis in the Asia-Pacific region, contributed to a decline in deliveries of screen plate cylinders and plates as no new capacity was required. As a result, it was opportune for CAE to consolidate its North American manufacturing operations into a single site in Lennoxville, Quebec. In October, the manufacturing facility in Glens Falls, New York, was closed, leaving a sales and service office at that location. The Lennoxville location is currently expanding its facilities to accommodate future growth.

Several new product initiatives were under development during the year, including the final design and testing of a new high-capacity screen – for which a patent is expected in the near future – known as MacroFlow™. These cylinders have been designed with a larger processing area combined with a high degree of mechanical strength. The new screen cylinder will improve screening capacity, performance, and reliability for customers.

Outlook

CAE ScreenPlates continues to be the world's leading supplier of precision engineered stainless steel cylinders and baskets. Further investments in new products and equipment, together with the cost reduction from consolidating the manufacturing operations in North America, position the company well for the future. Revenue is expected to improve in fiscal 1999 should the recovery in the pulp and paper industry take effect.

CAE TRISLOT

Operational Highlights

Financial performance improved over last year due to better market conditions in Europe and despite difficult market conditions in the Asia-Pacific region. The benefits of machine redesign to improve productivity and lower the cost of manufacturing, allowed for more competitive pricing. During the year, the company initiated the design and construction of a new machine to manufacture wedge wire cylinders to complement the products offered by CAE ScreenPlates.

Outlook

The company expects growth to continue in fiscal 1999 due to improving markets and the introduction if its new wedge wire product for the forest products industry. The company is exploring more advanced filtration products incorporating its high precision wedge wire elements. The outlook for the petrochemical internals business is improving due to the growing number of process licensors listing CAE Trislot as an approved vendor.

CAE MACHINERY

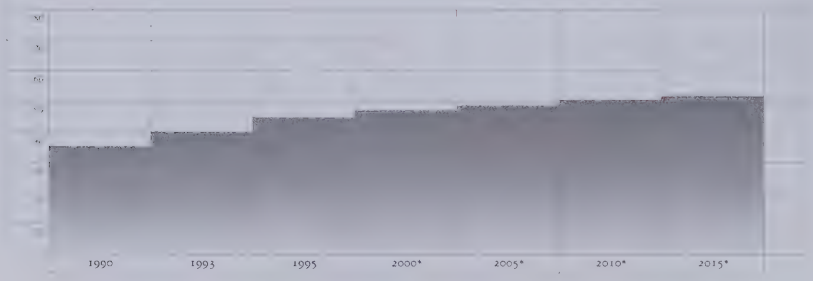
Operational Highlights

The slowdown in demand for capital equipment to produce oriented strand board caused a significant reduction in the sale of flakers and stranders. Three flakers were sold in fiscal 1998 compared with six flakers and five stranders in fiscal 1997. This decline was partially offset by a significant increase in revenue from spare parts and service to the large installed base of equipment.

CAE Machinery enjoyed greater success in the sale of King Debarkers. The patented King Debarker provides significant cost savings, eliminates the need for water and significantly increases potential yield per acre of forest compared with more conventional debarker technologies. Orders received during fiscal 1998 totaled eight as compared with three last year. Backlog of orders at year-end to be shipped next year was more than $4 million. One order shipped during the year was for $1.4 million to Northern Fibre

OSB SHARE OF TOTAL STRUCTURAL PANEL PRODUCTION

*(percent) (Source: APA) (*estimate)*



Over-capacity in the oriented strand board industry is currently affecting the market for OSB capital equipment. Demand for OSB is expected to continue to grow, however, with investment in new capacity resuming during fiscal 2000.

Inc. of Nova Scotia. The company will use the King Debarker as part of a CAE system including a chipper to produce 100,000 cubic meters of wood chips annually for Japan. Of particular significance was the sale of the first mobile King Debarker to Mexico. This unit allows flexibility for the customer to debark fiber at multiple locations.

Outlook

The operations of CAE Machinery are affected significantly by the demand for capital equipment in the oriented strand board industry. Improvements in this market are not anticipated until fiscal 2000. The demand for King Debarker Systems during fiscal 1999 is expected to grow beyond this year's level as this new technology gains further acceptance in the marketplace.

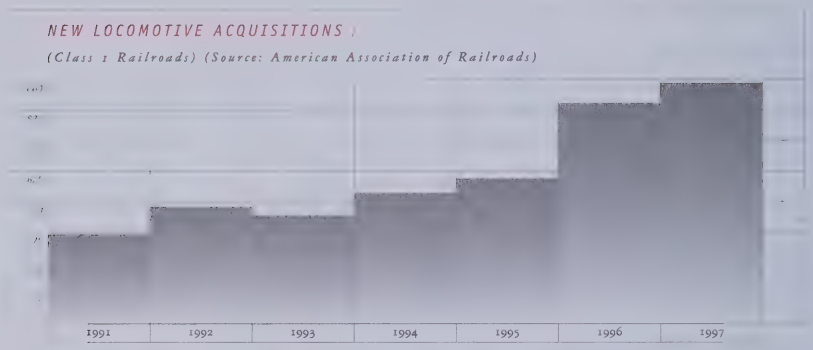
The company continues to focus on the introduction of new products, including an optical chip sorter; a machine stress rating system to measure the quality of oriented strand board, partially sponsored by major customers and public research institutes; and disposable knives for use on flakers and stranders. Several opportunities for these products are under discussion and if successful would further improve performance.

CAE VANGUARD

Operational Highlights

Two new facilities contributed to growth at CAE Vanguard in fiscal 1998. The first was a new plant in Kansas City started in fiscal 1997. A similar facility was opened in Knoxville in fiscal 1998. Both facilities perform maintenance work on locomotive traction motors and wheel set assemblies ('combos'). The work is part of an agreement with GE Transportation Systems to service GE-built locomotives. The agreement was developed to reduce GE's costs by locating the service near the customer and capitalize on CAE Vanguard's proven track record of providing mechanical maintenance services to the railroad industry.

The traditional side of CAE Vanguard's business has experienced growth in the supply of machined axles for both freight cars and locomotives. Much of the freight car growth is related to increased demand for intermodal services. This was supported by a consistent supply of new locomotive and freight car axle forgings. The company's axle rebuilding activities have declined as changes in wheel bearing technology have extended the life of axles and thereby reduced the frequency of repairs.



As the preferred supplier of life-cycle maintenance services for GE Transportation Systems locomotives, CAE Vanguard is well positioned to capitalize on the growing locomotives market.

Outlook

Opportunities for growth continue to follow the trend among Class 1 railways to outsource non-operational activities. CAE Vanguard anticipates opening a West Coast facility to accommodate growing demand for locomotive combo work. One of CAE Vanguard's key advantages is its multiple shop locations, which provide customers with local service and reduced logistics costs.

New products are also being introduced. The company is launching its traction motor conversion program this year. The process allows customers to upgrade older locomotives to roller bearing technology, which results in lower operating and maintenance costs. Customers have expressed significant interest in this patented technology. The company has also developed a proprietary rebuilding procedure that will allow customers to upgrade used axles to new specifications for ultimate use on new intermodal cars.

The company has identified the transit rail industry as a potential growth market. Based on aging transit equipment in North America, capital budgets for equipment replacements or overhaul are expected to total $5 billion over the next five years.

CAE CLEANING TECHNOLOGIES

As part of the overall strategy to achieve significant growth in the cleaning systems sector, the company recently formed CAE Cleaning Technologies. This new division comprises CAE Ransohoff and CAE Environmental Systems Group, acquired in October 1995, CAE Blackstone, acquired in January, 1997,

CAE Tempest & Dibb (U.K.) and CAE Ney Ultrasonics (U.S.A.); the latter two were acquired in February, 1998. All of these operating companies have unique technology and market position and are involved in the design and manufacture of industrial cleaning and oil waste minimization systems. This gives the group a variety of distinct product offerings for the international marketplace.

The formation of this group of companies under a common banner is the initial phase in establishing a worldwide leadership position in cleaning and associated waste minimization technologies. Further growth will be pursued through additional acquisitions and synergistic joint ventures in related areas as well as aggressive organic expansion of the existing business units.

Operational Highlights

Prior to the recent acquisitions, CAE Ransohoff and CAE Blackstone achieved record performance, leveraging off major program awards from Chrysler Corporation and Ford Motor Company in fiscal 1997. The companies' success continued throughout fiscal 1998 with a number of new contracts. These included orders from Navistar International Transportation company for the production of two highly automated in-line cleaning systems for processing cylinder blocks for their new diesel engine; Chrysler-Acustar for an in-line silicate coating system, the third such system built for this customer; and United Technologies for two large heat-exchanger cleaning systems.

In addition, CAE Cleaning Technologies made significant progress in the international market. For example, five large, custom cleaning systems were recently sold to customers in Taiwan.

Outlook

Recent acquisitions, the formation of a global entity for providing cleaning systems, further penetration in international markets and the continued requirement for environmentally compliant cleaning solutions all bode well for the future growth of CAE Cleaning Technologies. In addition, the company expects to make further investments in new businesses and related technologies in the coming year.

LIQUIDITY AND CAPITAL RESOURCES

CAE strengthened its financial flexibility to support future growth initiatives with the arrangement of a long-term financing of US$108 million and $20 million through a private placement of senior notes in the U.S. In addition, the company amended the terms of its bank credit agreements, increasing the syndicated U.S. dollar revolving bank facility from US$180 million to US$220 million and doubling the German revolving line of credit to 100 million Deutschmarks from 50 million Deutschmarks. The term of both the U.S. and German bank credit facilities was extended to five years from three years.

As a result of the U.S. private placement, a reduction in non-cash working capital and the proceeds from the sale of CAE Aviation, the company's cash position increased $179 million to $202.8 million as compared with an increase of $9.7 million in cash a year ago. The reduction in non-cash working capital was mainly attributable to higher deposits on contracts for several commercial and military simulation programs.

Capital expenditures, net of proceeds from fixed asset disposals, totaled $66.5 million compared with $46.6 million in fiscal 1997. This is the highest level ever recorded by CAE. Capital projects included facilities expansion at CAE Electronics plc and CAE ScreenPlates, Lennoxville, Quebec, to meet growth initiatives; the manufacture of four full flight simulators for long-term leases to specific customers; and strategic investments in new production equipment and information systems. Cash of $12.1 million was also used to fund the acquisitions of Tempest & Dibb and Ney Ultrasonics and $17.3 million was used for the payment of the $0.16 per share dividend, which was unchanged from last year.

CAE employs foreign exchange forward contracts to manage the exposure created when sales are made in foreign currencies. The amount and timing of forward contracts varies on a number of factors, including milestone billings and the use of foreign materials and subcontractors on the program. As at March 31, 1998, CAE had $352 million in Canadian equivalent foreign exchange contracts which, if marked to market at that date, would result in a foreign exchange loss of $5.9 million. These would be equally offset by future gains of foreign denominated cash flows over the balance of the contracts.

CAE also uses financial instruments to manage its exposure to changing interest rates and to adjust its mix of fixed and floating interest rate debt. At March 31, 1998, CAE had interest rate swaps covering long-term debt amounting to $76 million which, if marked to market at that date, would result in a gain of $5.6 million. CAE deals only with sound counterparties in executing any of its financial instruments.

CAE also has losses for income tax purposes to offset future earnings from U.S. operations. As at March 31, 1998, these losses stood at US$185 million.

BUSINESS RISKS AND UNCERTAINTIES

Market Cycles

CAE's companies operate in competitive global markets and are subject to worldwide economic trends and political influences. Many of the companies' products are affected by market cycles. The most recent example was in the commercial simulation market, where the level of new simulator orders was three times the annual average of the preceding five years. In contrast, sales for the Industrial Technologies Group were affected by lower pulp prices and excess capacity for the manufacture of oriented strand board. In addition to price, technology, life cycle costs, delivery and quality, military simulation programs, awarded mainly from governments, are also influenced by in-country presence. CAE has positioned itself in a variety of industries, geographically and by business sector, as a strategy to moderate these risks.

Product Innovation

The continued success of the company is also dependent upon the advancement of technology on existing products and the introduction of new products. In response, CAE expends a significant amount on research and development which, in many cases, is sponsored by the customer. Certain initiatives also receive the support of the Canadian Government through the Technology Partnership Program.

Changes in Contract Cost

CAE's operating results may fluctuate from a change in the cost to complete long-term fixed-price contracts. Typically they incorporate new technological solutions, the cost of which is difficult to estimate.

Key Personnel

CAE is dependent on the continued service of, and its ability to attract and retain, qualified technical personnel. CAE applies a compensation philosophy designed to mitigate this risk.

Year 2000

Certain computer programs and microprocessors use two digits rather than four to identify the current year. Date-sensitive software and microprocessors may recognize "00" as the year 1900 rather than the year 2000.

The year 2000 issue could conceivably disrupt the company's operations and those of its customers and suppliers who face the same issue. To decrease the likelihood of any disruption, CAE has committed internal resources to address the year 2000 issue.

In addition, each operating company is required to report on the status of year 2000 compliance. These reports are reviewed with the Audit Committee.

CAE is in contact with its suppliers to assess the potential effect of the year 2000 issue. There is, however, no means to ensure that all Company suppliers will achieve year 2000 compliance in a timely manner.

CAE has also initiated communications with its customers on this matter. The Company has identified where it will be required to either modify or replace certain portions of its software and related hardware systems. The cost of such modifications and replacements is not expected to have a material cost impact. CAE has already commenced modifications and upgrades to installed products where the year 2000 is expected to have an impact. Modifications are expected to be completed in a timely manner.

MANAGEMENT REPORT

Management is responsible for the integrity and objectivity of the information contained in this annual report and for the consistency between the financial statements and other financial and operating data contained elsewhere in the report. The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada, using policies and procedures established by management, and reflect the Corporation's financial position, results of operations, and changes in financial position.

Management has established and maintains a system of internal control which is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and that financial information is reliable and accurate. The Corporation also maintains an internal audit department that evaluates and formally reports to management and the Audit Committee on the adequacy and effectiveness of internal controls.

The financial statements have been examined by external auditors appointed by the shareholders. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and financial condition. They obtain an understanding of the Corporation's accounting systems and procedures and conduct such tests and related procedures as they deem necessary to arrive at an opinion on the fairness of the financial statements.

Ultimate responsibility to the shareholders for the financial statements rests with the Board of Directors. An Audit Committee is appointed by the Board to review the financial statements in detail and to report to the Directors prior to such statements being approved for publication. The Audit Committee meets regularly with management, the internal auditors and the external auditors to discuss their evaluation of internal accounting controls, audit results and the quality of financial reporting. The external auditors have free access to the Audit Committee, without management's presence, to discuss the results of their audit.

John E. Caldwell
President and
Chief Executive Officer

Paul G. Renaud
Vice President, Finance,
Chief Financial Officer, and Secretary

AUDITORS' REPORT TO THE SHAREHOLDERS OF CAE INC.

We have audited the consolidated balance sheets of CAE Inc. as at March 31, 1998 and 1997 and the consolidated statements of earnings, retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at March 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

PRICE WATERHOUSE
Chartered Accountants

TORONTO, CANADA
APRIL 28, 1998

CONSOLIDATED BALANCE SHEETS

as at March 31 (Amounts in thousands of dollars)	1998	1997
ASSETS		
CURRENT ASSETS		
Cash	$ 202,811	$ 23,852
Accounts receivable	283,432	239,815
Inventories (note 4)	84,419	92,443
Prepaid expenses	7,656	6,442
Income taxes recoverable	3,399	14,328
	581,717	376,880
PROPERTY, PLANT AND EQUIPMENT, NET (note 5)	197,680	181,229
GOODWILL	76,691	82,817
OTHER ASSETS (note 6)	72,091	57,835
	$ 928,179	$ 698,761
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 246,655	$ 219,385
Deposits on contracts	93,100	46,834
Long-term debt due within one year	1,072	1,238
	340,827	267,457
LONG-TERM DEBT (note 7)	269,855	158,310
OTHER LONG-TERM LIABILITIES	17,233	25,483
DEFERRED INCOME TAXES	23,811	18,930
	651,726	470,180
SHAREHOLDERS' EQUITY		
Capital stock (note 9)	145,070	142,046
Retained earnings	134,668	82,081
Currency translation adjustment	(3,285)	4,454
	276,453	228,581
	$ 928,179	$ 698,761

Approved by the Board:

JOHN E. CALDWELL
Director

DAVID H. RACE
Director

CONSOLIDATED STATEMENTS OF EARNINGS

Years ended March 31 (Amounts in thousands of dollars, except per share amounts)	1998	1997
REVENUE	$ 922,369	$ 867,344
COSTS AND EXPENSES		
Manufacturing	687,365	645,173
Selling and administrative	105,847	108,209
Depreciation and amortization	29,857	28,317
Interest expense, net	8,745	4,190
Other items (note 3)	(5,997)	–
	825,817	785,889
Earnings Before Income Taxes	96,552	81,455
Income Taxes (note 10)	26,316	21,179
NET EARNINGS	$ 70,236	$ 60,276
NET EARNINGS PER SHARE	$ 0.64	$ 0.55
AVERAGE NUMBER OF SHARES OUTSTANDING	110,244	109,528

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended March 31 (Amounts in thousands of dollars)	1998	1997
RETAINED EARNINGS AT BEGINNING OF YEAR	$ 82,081	$ 39,347
Net Earnings	70,236	60,276
Dividends	(17,649)	(17,542)
Retained Earnings at End of Year	$ 134,668	$ 82,081

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended March 31 (Amounts in thousands of dollars)	1998	1997
OPERATING ACTIVITIES		
Net earnings	$ 70,236	$ 60,276
Add items not affecting cash		
Depreciation and amortization	29,857	28,317
Deferred income taxes	8,508	8,395
Gain on disposition of business (note 3)	(19,000)	–
Other	(2,060)	1,398
	87,541	98,386
Provided by (Used in) non-cash working capital (note 11)	23,693	(142,871)
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	111,234	(44,485)
INVESTING ACTIVITIES		
Proceeds on disposition of business (note 3)	67,192	–
Acquisitions (note 2)	(12,073)	(7,992)
Purchase of property, plant and equipment, net of proceeds from disposal	(66,473)	(46,555)
Investment and other assets	(14,103)	(6,075)
CASH USED IN INVESTING ACTIVITIES	(25,457)	(60,622)
FINANCING ACTIVITIES		
Net advance of long-term debt	118,214	133,440
Dividends, net of stock dividends	(17,256)	(17,268)
Other	(7,776)	(1,396)
CASH PROVIDED BY FINANCING ACTIVITIES	93,182	114,776
CASH INCREASE DURING THE YEAR	178,959	9,669
CASH AT BEGINNING OF YEAR	23,852	14,183
CASH AT END OF YEAR	$ 202,811	$ 23,852

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended March 31, 1998 and 1997
(Tabular amounts in thousands of dollars)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting policies of the Corporation and its subsidiaries conform with generally accepted accounting principles in Canada and reflect practices appropriate to the industries in which they operate.

Consolidation

The consolidated financial statements include the accounts of the Corporation and all subsidiaries. All inter-corporate accounts and transactions have been eliminated.

Acquisitions are accounted for by the purchase method and accordingly the results of operations of subsidiaries are included from the dates of acquisition.

Portfolio investments are accounted for using the cost method.

Revenue Recognition

Revenue from long-term contracts is recognized using the percentage of completion method, where revenue, earnings and unbilled accounts receivable are recorded as related costs are incurred. Revisions in cost and earnings estimates during the term of the contract are reflected in the period in which the need for the revision becomes known. Losses, if any, are recognized fully when first anticipated.

All other revenue is recorded and related costs transferred to cost of sales at the time the product is shipped or the service is provided.

Cash

Cash consists of cash and cash equivalents which are short term, highly liquid investments with maturity of 90 days or less.

Inventories

Inventories are stated at the lower of average cost and net realizable value.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. The declining balance and straight line methods are used in computing depreciation of property, plant and equipment based on the following useful lives: buildings and improvements, 20 to 40 years; machinery and equipment, 3 to 10 years; property under capital lease, over the term of the lease.

Financial Instruments and Foreign Currency Translation

Assets and liabilities denominated in currencies other than Canadian dollars are translated at exchange rates in effect at the balance sheet date. Revenue and expense items are translated at average rates of exchange for the year. Translation gains or losses are included in the determination of earnings, except for gains or losses arising on translation of accounts of foreign subsidiaries considered self-sustaining and gains or losses arising from the translation of foreign currency debt that has been designated as a hedge of the net investment in subsidiaries, which are deferred as a separate component of shareholders' equity. Gains or losses arising from the translation of foreign currency debt not designated as a hedge of the net investment in subsidiaries are deferred and amortized on a straight line basis over the term of the debt.

The Corporation enters into forward contracts to manage exposures resulting from foreign exchange fluctuations in the ordinary course of business. The contracts are normally for terms up to twelve months and are used as hedges of foreign denominated cash flows. Gains and losses on outstanding contracts are offset against the gains and losses of the hedged item at the maturity of the underlying transactions. The company negotiates forward contracts only with financially sound counterparties.

The carrying value of assets and liabilities approximate fair value except where indicated.

Goodwill

The excess purchase price paid on the acquisition of businesses over the value assigned to identifiable net assets acquired is allocated to goodwill. Goodwill is stated at cost less accumulated amortization and is being amortized on a straight line basis over 40 years. The value of goodwill is evaluated by reviewing the returns of the related business, taking into account the risk associated with the business, and is written down when there has been an impairment of its value.

Income Taxes

The Corporation follows the tax allocation method of accounting for income taxes whereby earnings are charged with income taxes relating to reported earnings. Differences between such taxes and taxes currently payable or recoverable are reflected in deferred income taxes and arise because of differences between the time certain items of revenue and expense are reported in the accounts and the time they are reported for income tax purposes. Investment tax credits arising from

research and development are deducted from the related costs and are accordingly included in the determination of earnings in the same year as the related costs. Investment tax credits arising from the acquisition of property, plant and equipment are deducted from the cost of those assets with depreciation calculated on the net amount.

Post Retirement Benefits

Pensions

Pension expense includes the cost of pension benefits, related to defined benefit plans, accrued for employees' services for the year and the past service costs, adjustments for plan amendments, and experience gains and losses amortized on a straight line basis over the expected average remaining service life of the plan participants.

Benefits Other Than Pensions

The Corporation accrues estimates of future costs of retiree post employment benefits over the employees' average remaining service lives.

Other Long-term Liabilities on the consolidated balance sheet primarily comprise the long-term portion of all post employment benefits.

Earnings Per Share

The calculation of earnings per share is based on the weighted average number of shares outstanding. Conversion of the outstanding stock options would not materially dilute earnings per share.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the period reported. Actual results could differ from those estimates.

2. ACQUISITIONS

During fiscal 1998, the Corporation made the following acquisitions:

- Effective February 27, 1998, the Corporation acquired the outstanding common shares of Tempest & Dibb Ltd., a manufacturer of industrial part washers located in Bradford, England for cash.
- Effective February 28, 1998, the Corporation acquired the assets of Ney Ultrasonics, Inc. of Bloomfield, Connecticut, a manufacturer of ultrasonics cleaning equipment for cash and future consideration based on future earnings of the acquired company.

Effective January 6, 1997, the Corporation acquired the outstanding common shares of Sonicstar International Ltd., a U.S. manufacturer of ultrasonic cleaning equipment and associated systems, for cash and future consideration based on future earnings of the acquired company.

The net assets acquired from these acquisitions, at fair values, are summarized as follows:

	1998	1997
Net working capital	$ 4,180	$ 1,810
Property, plant and equipment	1,349	928
Goodwill	6,544	5,254
	$ 12,073	$ 7,992

3. OTHER ITEMS

	1998
Gain on disposition of CAE Aviation (i)	$ (19,000)
Foreign currency translation gain (ii)	(7,495)
Reorganization and rationalization of certain product lines (iii)	13,344
Consolidation of screen plate manufacturing operations (iv)	4,500
Writedown of investment in subsidiary (v)	2,654
	$ (5,997)

(i) Disposition of CAE Aviation

On January 28, 1998 the Corporation completed the sale of substantially all the assets of CAE Aviation Ltd., a wholly-owned subsidiary that provides aircraft maintenance system upgrades and publication services for commercial and military aircraft, resulting in a gain on disposition of $19 million. The Corporation received cash proceeds of $57.5 million on closing and a further $9.7 million is receivable from the purchaser representing the increase in the net assets sold between September 30, 1997, the reference date on which the transaction was valued, and the closing date of January 28, 1998. The purchase price is subject to further increases contingent upon the future award of a specific contract the outcome of which is not currently determinable.

(ii) Foreign Currency Translation Gain

During the year, the Corporation reorganized the ownership structure of its European wholly-owned subsidiary companies. As a result of the reorganization, a $7.5 million gain from foreign currency translation adjustments, previously deferred as part of Shareholders' Equity, was realized.

(iii) Reorganization and Rationalization of Certain Product Lines

During the year, CAE Electronics Ltd. was reorganized along four product lines – Commercial Simulation and Visual Systems, Military Simulation and Training, Energy Control Systems and Marine Control Systems. As part of the reorganization and after careful review of future opportunities and the likelihood of achieving acceptable financial returns, the Corporation decided to discontinue its activities in certain product lines. Total costs of $13.3 million have been incurred or provided with respect to the reorganization and the discontinuation of these product lines representing expenditures made during the year and the writedown of related assets to net realizable value.

(iv) Consolidation of North American Screen Plate Manufacturing

In September 1997, the Corporation announced and subsequently completed the consolidation of its North American screen plate manufacturing operations to its Lennoxville, Quebec facility resulting in the closure of the Glens Falls, New York manufacturing operation. The cost for employee terminations and the writedown of assets to net realizable value was $4.5 million.

(v) Writedown of Investment in Swedish Screen Plate Operation

As at March 31, 1998, it was determined that there had been an impairment in the carrying value of the Swedish screen plate operation and accordingly, the Corporation wrote down the carrying value by $2.7 million.

4. INVENTORIES

	1998	1997
Work in progress	$ 52,862	$ 58,351
Raw materials, supplies and manufactured products	31,557	34,092
	$ 84,419	$ 92,443

5. PROPERTY, PLANT AND EQUIPMENT

1998	Cost	Accumulated Depreciation & Amortization	Net Book Value
Land	$ 9,529	$ –	$ 9,529
Buildings and improvements	113,185	32,031	81,154
Machinery and equipment	227,457	127,489	99,968
Property under capital leases	11,447	4,418	7,029
	$ 361,618	$ 163,938	$ 197,680

1997	Cost	Accumulated Depreciation & Amortization	Net Book Value
Land	$ 6,902	$ –	$ 6,902
Buildings and improvements	118,320	44,993	73,327
Machinery and equipment	210,826	120,473	90,353
Property under capital leases	15,667	5,020	10,647
	$ 351,715	$ 170,486	$ 181,229

6. OTHER ASSETS

	1998	1997
Investment tax credits (i)	$ 56,694	$ 52,806
Deferred charges (ii)	8,596	1,190
Investment in and advances to CVS Leasing Ltd. (ii)	5,235	–
Other	1,566	3,839
	$ 72,091	$ 57,835

(i) Investment tax credits are available to reduce future federal income taxes payable in Canada.

(ii) During the year, the Corporation led a consortium which was contracted by the U.K. Ministry of Defence ("MoD") to design, construct, manage, finance and

operate an integrated simulator based aircrew training facility for the Medium Support Helicopter fleet of the Royal Air Force. The contract covers a 40 year period, which can be terminated by the MoD after 20 years.

In connection with the contract, the Corporation has established a subsidiary which it owns 74 percent thereof with the balance held by the other consortium partners. This subsidiary will lease the land from the MoD, build the facility and operate the training centre, and has been consolidated with the accounts of the Corporation.

The pre-operating expenditures in connection with this contract are being deferred until the aircrew training facility is ready for training and will be amortized over the remaining life of the initial 20 year period of the contract.

In addition, the Corporation has a minority shareholding of 11 percent in, and has advanced funds to, CVS Leasing Ltd., a company established to acquire the simulators and other equipment which will be leased to the subsidiary.

7. DEBT FACILITIES

A. Long-term Debt

	1998	1997
Senior notes (i), (v)	$ 172,993	$ –
Five-year revolving term loan, to a maximum of US$220,000, unsecured, due May 31, 2002 (1998 – US$nil, 1997 – US$93,910) (ii), (v)	–	130,000
Five-year revolving term loan, to a maximum of Deutschmark 100,000, unsecured, due May 31, 2002 (1998 – DM 100,000, 1997 – DM 26,000) (ii), (v)	76,590	21,588
Eighteen-year term loan, to a maximum of £12,700, secured, maturing April 1, 2001 to October 1, 2015 (1998 – £6,218, 1997 – £nil) (iii), 6 (ii), (v)	14,745	–
Obligations under capital lease commitments (iv), (v)	6,599	7,960
	270,927	159,548
Less: Long-term debt due within one year	1,072	1,238
	$ 269,855	$ 158,310

(i) In June 1997 pursuant to a private placement with certain investors, the Corporation borrowed US$108 million and $20 million. These unsecured senior notes, which rank

equally with the term bank financing are repayable after 8, 10, 12 and 15 years. Fixed interest of approximately 7.5% is payable semiannually in June and December.

(ii) Interest on bank term loans is charged at rates approximating LIBOR.

(iii) In October 1997 the Corporation arranged project financing for its subsidiary to finance the Corporation's Medium Support Helicopter Program for the Ministry of Defence in the United Kingdom. This term loan is secured by the project assets of the subsidiary and is repayable over 18 years to October 1, 2015. Interest on the loan is charged at a rate approximating LIBOR.

(iv) The effective interest rate on obligations under capital leases was approximately 7.3% (1997 – 7.0%).

(v) Payments required in each of the next five years to meet the retirement provisions of the long-term debt are as follows:

Year ending March 31,		
	1999	$ 1,072
	2000	1,235
	2001	2,942
	2002	4,072
	2003	80,738
	Thereafter	180,868
		$ 270,927

Interest expense on long-term debt was $10.0 million (1997 – $3.7 million).

The fair value of the long-term debt at March 31, 1998 is approximately $289 million.

B. Short-term Debt

The Corporation has unsecured bank lines of credit available in various currencies totaling $91.8 million (1997 – $101.6 million). The effective interest rate on short-term borrowings was 5.9% (1997 – 6.3%).

8. FINANCIAL INSTRUMENTS

The Corporation has estimated the fair values of its financial instruments as at March 31, 1998 using quoted market values where available and other information.

At March 31, 1998, the Corporation had outstanding forward contracts to hedge its foreign currency cash flows into Canadian dollars. These forward exchange contracts have maturity dates up to August 2000. The fair value of these contracts if marked to market at March 31, 1998 would result in a loss of $5.9 million. This would be equally offset by future gains of foreign denominated cash flows over the remaining terms of the contracts.

Effective June 9, 1997 the Corporation entered into interest rate swap agreements with two financial institutions for a total nominal value of $67 million whereby in the first instance the Corporation will receive a fixed interest rate of 7.2% semiannually for 8 years and in the second instance the Corporation will receive a fixed interest rate of 7.7% semiannually for 15 years. In both cases, the Corporation will pay quarterly variable interest established at bankers acceptance rates.

Pursuant to the requirements of its long-term project financing, on October 16, 1997, the Corporation's subsidiary entered into an interest rate swap agreement with two financial institutions for a maximum total nominal value of £12.7 million whereby the subsidiary will receive payments of floating rate interest and will pay a fixed interest rate of 6.8% semiannually for 13 years.

The fair value of the interest rate swap agreements, if marked to market at March 31, 1998, would result in a gain of $5.6 million.

9. CAPITAL STOCK

(i) The Corporation's articles of incorporation authorize the issue of an unlimited number of preferred shares, issuable in series, and an unlimited number of common shares. To date the Corporation has not issued any preferred shares.

(ii) A reconciliation of the issued common shares of the Corporation follows:

	1998		1997	
	Number of Shares	*Stated Value*	*Number of Shares*	*Stated Value*
Balance at beginning of year	110,040,146	$ 142,046	109,364,674	$ 137,779
Stock options (a)	415,101	2,631	649,813	3,993
Stock dividends (b)	35,158	393	25,659	274
Balance at end of year	110,490,405	$ 145,070	110,040,146	$ 142,046

(a) During the year, the Corporation granted 598,000 options, exercisable at $11.40 per share, to purchase common shares to certain officers and key employees of the Corporation and its subsidiaries. The option price was equal to the closing price of the common shares on the Toronto Stock Exchange on the trading day immediately prior to the day the stock options were issued.

Stock options were outstanding at March 31, 1998 for the purchase of 2,403,949 common shares at prices ranging from $5.00 to $11.40 and expiring during the period from 1998 to 2003. There were 415,101 options exercised in the year, and 158,800 options that expired.

(b) The Corporation provides that its shareholders may elect to receive common stock dividends in lieu of cash dividends.

(c) The Corporation has a Plan for the Equal Treatment of Shareholders whereby one right has been issued for each outstanding common share of the Corporation. The rights remain attached to the shares and are not exercisable until the occurrence of certain designated events. The rights expire on March 7, 2000, unless terminated at an earlier date by the Board of Directors.

10. INCOME TAXES

The provision for income taxes comprises:

	1998	1997
Current	$ 17,808	$ 12,784
Deferred	8,508	8,395
	$ 26,316	$ 21,179

The Corporation's effective income tax provision has been determined as follows:

	1998	1997
Combined federal and provincial statutory rate (1998 and 1997 – 44.6%)	$ 43,081	$ 36,347
Income taxed at different rates in other jurisdictions	(9,415)	(7,832)
Manufacturing and processing allowance	(6,285)	(4,424)
Tax benefit of losses not previously recognized	2,745	(2,245)
Research and development investment tax credits	(890)	(1,274)
Other	(2,920)	607
Income taxes	$ 26,316	$ 21,179

At March 31, 1998, the Corporation had accumulated non-capital losses for income tax purposes relating to operations in the United States, the potential benefit of which has not been recognized in the financial statements, as follows:

	(Stated in U.S. dollars)
Losses for income tax purposes	$ 170,000
Amounts provided for in the financial statements which have not yet been claimed for income tax purposes	15,000
	$ 185,000

The losses for income tax purposes expire in the years 2005 through 2013.

11. SUPPLEMENTARY CASH FLOW INFORMATION

Cash provided by (used in) non-cash working capital:

	1998	1997
Accounts receivable	$ (56,480)	$ (75,506)
Inventories	(14,322)	(6,706)
Prepaid expenses	(1,233)	(2,847)
Income taxes recoverable	9,004	(13,887)
Accounts payable and accrued liabilities	41,384	21,504
Deposits on contracts	45,340	(65,429)
	$ 23,693	$ (142,871)

12. CONTINGENCIES

Through the normal course of operations, the Corporation is party to a number of lawsuits, claims and contingencies. Accruals are made in instances where it is probable that liabilities will be incurred and where such liabilities can be reasonably estimated. Although it is possible that liabilities may be incurred in instances for which no accruals have been made, the Corporation has no reason to believe that the ultimate outcome of these matters will have a material impact on its financial position.

13. GOVERNMENT COST SHARING

During fiscal 1997, the Corporation signed an agreement with the Government of Canada under which the government will share in the costs of certain research and development programs over the period from 1997 to 2001. Funding under this program will not exceed $31.2 million and is repayable in the form of royalties based on future sales levels related to the projects funded. Funding of $11.6 million (1997 – $4.8 million) received or receivable under this program to date reduced research and development expenses.

14. OPERATING LEASE COMMITMENTS

Future minimum lease payments under operating leases, the most significant of which relate to the Medium Support Helicopter contract with the U.K. MoD as described in Note 6(ii), are as follows:

Year ending March 31,		
	1999	$ 3,810
	2000	11,836
	2001	33,832
	2002	29,773
	2003	32,318
	Thereafter	265,901
		$ 377,470

15. PENSIONS

The Corporation has defined benefit plans that provide benefits based on length of service and final average earnings. The Corporation has an obligation to ensure there are sufficient funds in the plans to pay the benefits earned.

The actuarial present value of accrued pension benefits has been estimated taking into consideration economic and demographic factors over an extended future period. Significant assumptions used in the calculation are as follows:

	1998	1997
Return on plan assets	9.0%	9.0%
Discount rate for pension benefit obligations	8.0%	8.0%
Compensation rate increases	3.5–6.0%	5.5%

The funded status of the defined benefit pension plans at March 31 was as follows:

Market value of assets	$ 117,587	$ 105,514
Present value of accrued pension benefits	$ 95,409	$ 98,294

16. BUSINESS SEGMENTS

The Electronics segment of the Corporation is engaged in the development and production of electronic simulation training systems and devices for commercial airlines, the military, and space agencies. This segment also provided repair and overhaul services for military aircraft.

The Industrial Technologies segment of the Corporation is engaged in the manufacture of engineered machinery for the forest products industry, the manufacture of custom-made steel screen plates and baskets for the pulp and paper and food industries, the manufacture of environmentally compliant aqueous cleaning machinery for machined parts, and the provision of wheel and axle services for railways.

Financial information on the Corporation's industry and geographic segments is shown in the following table.

BUSINESS SEGMENTS:

	Electronics		*Industrial Technologies*		*Consolidated*	
	1998	1997	1998	1997	1998	1997
Revenue	$ 715,272	$ 656,310	$ 207,097	$ 211,034	$ 922,369	$ 867,344
Earnings	$ 74,384	$ 57,790	$ 24,712	$ 28,046	$ 99,096	$ 85,836
Corporate expense, net					204	(191)
Other items					5,997	–
Interest expense					(8,745)	(4,190)
Earnings before income taxes					$ 96,552	$ 81,455
Identifiable assets	$ 585,389	$ 489,863	$ 189,947	$ 196,554	$ 775,336	$ 686,417
Other assets, net					152,843	12,344
Total assets					$ 928,179	$ 698,761
Capital expenditures, net of proceeds from disposal	$ 57,431	$ 29,856	$ 9,042	$ 16,699	$ 66,473	$ 46,555
Depreciation and amortization	$ 19,474	$ 18,447	$ 10,383	$ 9,870	$ 29,857	$ 28,317

GEOGRAPHIC SEGMENTS:

	North America		*Europe & Australia*		*Consolidated*	
	1998	1997	1998	1997	1998	1997
Revenue	$ 720,646	$ 650,316	$ 201,723	$ 217,028	$ 922,369	$ 867,344
Earnings	$ 86,333	$ 72,839	$ 12,763	$ 12,997	$ 99,096	$ 85,836
Corporate expense, net					204	(191)
Other items					5,997	–
Interest expense					(8,745)	(4,190)
Earnings before income taxes					$ 96,552	$ 81,455
Identifiable assets	$ 554,805	$ 511,003	$ 220,531	$ 175,414	$ 775,336	$ 686,417
Other assets, net					152,843	12,344
Total assets					$ 928,179	$ 698,761
Capital expenditures, net of proceeds from disposal	$ 35,144	$ 33,975	$ 31,329	$ 12,580	$ 66,473	$ 46,555
Depreciation and amortization	$ 20,937	$ 19,918	$ 8,920	$ 8,399	$ 29,857	$ 28,317

EXPORT SALES FROM CANADA:

	1998	1997
United States	$ 230,400	$ 119,454
Europe	118,927	107,317
Asia	79,219	130,132
Other	52,794	37,198
	$ 481,340	$ 394,101

RESEARCH AND DEVELOPMENT

Research and development expenditures aggregated $96.6 million during the year (1997– $101.3 million).

*(Amounts in thousands of dollars except when indicated by *)*	1998	1997	1996	1995	1994
CONTINUING OPERATIONS					
Revenue	$ 922,369	867,344	809,803	657,592	591,147
Depreciation and amortization	$ 29,857	28,317	22,719	16,613	15,318
Earnings	$ 70,236	60,276	58,591	47,327	34,741
Earnings per share*	$ 0.64	0.55	0.54	0.44	0.32
Net earnings (loss)	$ 70,236	60,276	58,591	15,631	(394,960)
Net earnings (loss) per share*	$ 0.64	0.55	0.54	0.14	(3.64)
Ratio of current assets to current liabilities*	1.7	1.4	0.9	1.0	0.9
Number of registered shareholders*	2,800	3,100	3,400	3,800	4,200
Cash dividends paid per common share*	$ 0.16	0.16	0.16	0.16	0.16

QUARTERLY FINANCIAL INFORMATION

(Amounts in thousands of dollars except per share amounts)	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
1998				
Revenue	$ 186,933	212,316	243,664	279,456
Net earnings	$ 7,926	9,152	21,007	32,151
Net earnings per share	$ 0.07	0.08	0.19	0.30
Common share trading range:				
High	$ 11.75	11.80	13.00	11.60
Low	$ 10.20	10.40	10.90	10.95

(Amounts in thousands of dollars except per share amounts)	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
1997				
Revenue	$ 221,517	222,997	204,246	218,584
Net earnings	$ 13,165	12,041	17,181	17,889
Net earnings per share	$ 0.12	0.11	0.16	0.16
Common share trading range:				
High	$ 12.55	11.85	11.40	12.20
Low	$ 11.10	10.05	9.90	10.30

LETTER FROM DAVID H. RACE

> Earlier this year, the Board of Directors considered three important questions. How does the Board currently spend its time? How should the Board spend its time? Should the role and function of the Board change to further strengthen the Company and its value for shareholders?

In addressing those questions, we concluded that the Board of the Future must do more than oversee management, review and accept business plans and monitor progress against objectives. Those statutory responsibilities will continue to be an important part of our governance, of course. But we believe an increasingly important function of your Board is to give management the benefit of its skills and experience as business people in this rapidly changing business environment. Both collectively and individually, the Board of the Future at CAE will assist and provide counsel to management in the development of appropriate goals and strategies for the Company. We will also ensure that management has considered the necessary human and capital resources to successfully carry out the approved strategies. While management will remain accountable for setting strategy, they will gain the advantage of increased Board participation in its development.

A number of changes in the membership of your Board have occurred. In June, Mr. Alonzo McDonald will be retiring from the Board, having served 8 years as a Director. On behalf of the Company's shareholders, we wish to thank Mr. McDonald for his counsel and contributions during his tenure as a CAE Director.

The Board also appointed Mr. Lynton Wilson, Chairman of the Board of BCE Inc. and Mr. Lawrence Stevenson, President and Chief Executive Officer of Chapters, Inc. as Directors of the Company. These gentlemen undoubtedly will bring new and valuable insights to the Board.

In many companies, the Board of Directors is an under-utilized resource. This has not been so and will not be so at CAE. Your Board will be more involved in assisting CAE attain new levels of growth and value in the years ahead. This, we believe, is our fundamental responsibility to shareholders.

David Race

DAVID H. RACE
Chairman of the Board of Directors

David H. Race[1,3,4,5]
Chairman of the
Board of Directors
CAE Inc.
Toronto, Ontario

John E. Caldwell[1]
President and
Chief Executive Officer
CAE Inc.
Toronto, Ontario

R. Fraser Elliott, C.M., Q.C.[1]
Senior Partner
Stikeman, Elliott
Toronto, Ontario

H. Garfield Emerson, Q.C.[2]
President and
Chief Executive Officer
Rothschild Canada Limited
Toronto, Ontario

The Honourable
James A. Grant, P.C., Q.C.[1,3]
Partner
Stikeman, Elliott
Montreal, Quebec

James F. Hankinson[2]
President and
Chief Executive Officer
New Brunswick Power
Corporation
Fredericton, New Brunswick

Roderick L. Henry[4,5]
President
Henrod Investments Inc.
Montreal, Quebec

Michael M. Koerner, C.M.[4,5]
President
Canada Overseas Investments
Limited
Toronto, Ontario

James W. McCutcheon, Q.C.[3]
Counsel
McCarthy Tétrault
Toronto, Ontario

Alonzo L. McDonald[4,5]
Chairman and
Chief Executive Officer
Avenir Group, Inc.
Birmingham, Michigan, U.S.A.

George K. Petty[3]
President and
Chief Executive Officer
TELUS Corporation
Edmonton, Alberta

Lawrence N. Stevenson
President and
Chief Executive Officer
Chapters, Inc.
Toronto, Ontario

Dr.-Ing. Hasso von
Falkenhausen[2]
Chairman of the
Board of Directors
DataCard Corp.
Minneapolis, Minnesota,
U.S.A.

Lynton R. Wilson, O.C.[2, 3, 4]
Chairman of the Board
BCE Inc.
Montreal, Quebec

1 Member of the Executive Committee
2 Member of the Audit Committee
3 Member of the Compensation Committee
4 Member of the Governance Committee
5 Member of the Board Succession Committee

David H. Race
Chairman of the
Board of Directors

John E. Caldwell
President and
Chief Executive Officer

Fred Veuger
President
Industrial Technologies Group

Paul G. Renaud
Vice President, Finance,
Chief Financial Officer, and
Secretary

Robert E. Waite
Vice President
Corporate Relations and
Marketing

Allan M. Bignell
Vice President
Business Development

Ruth H. Brothers
Vice President
Human Resources

Michael A. Cossar
Treasurer

Kathy A. Chant
Controller and
Assistant Secretary

HEAD OFFICE

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Fax + 44 (0)1-444-244895

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Fax + 46-11-136950

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Fax + 32-56-627262

CAE Vanguard, Inc.
Minneapolis, Minnesota
Tel (612) 896-3915
Fax (612) 896-3913

Greenup, Kentucky
Kansas City, Missouri
Knoxville, Tennessee
Lincoln, Nebraska
Montreal, Quebec
Pocatello, Idaho
Winnipeg, Manitoba

CAE COMMON SHARES

CAE's shares are traded both on the Toronto Stock Exchange and the Montreal Stock Exchange under the symbol "CAE".

DIVIDEND REINVESTMENT PLAN

Registered shareholders of CAE Inc. wishing to receive dividends in the form of CAE Inc. Common Shares rather than a cash payment may participate in CAE's dividend reinvestment plan.

Through this plan, quarterly dividends can be reinvested in CAE Common Shares at the Average Market Price. This price will be the weighted average trading prices of the Common Shares on each of the Toronto Stock Exchange and the Montreal Stock Exchange for the five (5) trading days immediately preceding the dividend payment date.

In order to obtain the dividend reinvestment plan form or for additional information regarding CAE's Common Shares, please contact:
Montreal Trust Company
Tel: (416) 981-9500

DIRECT DEPOSIT DIVIDEND

Registered shareholders who receive cash dividends may elect to have the dividend payment deposited directly to their bank account instead of receiving a cheque. In order to obtain the direct deposit dividend form please contact:
Montreal Trust Company
Tel: (416) 981-9500

TENTATIVE QUARTERLY RESULTS RELEASE DATES FOR FISCAL 1999

August 6, 1998
November 5, 1998
February 4, 1999
May 6, 1999

ADDITIONAL INFORMATION

If you wish to receive additional copies of CAE's annual report or copies of the annual information form, please contact:
CAE Inc.
Corporate Relations
Royal Bank Plaza, Suite 3060,
Toronto, Ontario M5J 2J1
Tel: (416) 865-0070 1-800-760-0667
Internet address: http://www.cae.com

VERSION FRANÇAISE

La version française du rapport annuel est disponible sur demande au département des relations d'entreprise, Royal Bank Plaza, Bureau 3060, C.P. 30, Toronto, Ontario M5J 2J1

ANNUAL AND SPECIAL MEETING

The Annual and Special Meeting of shareholders will be held at the Glenn Gould Studio, CBC Building, 250 Front Street West, Toronto, on Wednesday, June 17, 1998, at 11:30 a.m.

AUDITORS

Price Waterhouse, Chartered Accountants
Toronto, Ontario

TRANSFER AGENT AND REGISTRAR

Montreal Trust Company
Toronto, Ontario
Montreal, Quebec
Vancouver, British Columbia

TRADEMARKS

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Printed in Canada

CAE 1998 ANNUAL REPORT SURVEY

We would appreciate a few minutes of your time to complete this survey about the 1998 CAE Annual Report.

1) Are you a:

◯ Shareholder (individual) ◯ Shareholder (institutional) ◯ Shareholder (potential)
◯ Media ◯ Analyst ◯ Broker ◯ Corporation

2) Approximately how much of the report did you read?

◯ Less than 10 percent ◯ About one-third ◯ About half
◯ About two-thirds ◯ More than two-thirds

3) Please give us your assessment of the overall quality, communications effectiveness and readability of the report.

(scale of 1-5, very poor, poor, fair, good, excellent)

1	2	3	4	5	Corporate overview
1	2	3	4	5	Company and customer stories
1	2	3	4	5	Letter from the President
1	2	3	4	5	Management's Discussion and Analysis
1	2	3	4	5	Financial statements and notes
1	2	3	4	5	Letter from the Chairman
1	2	3	4	5	Shareholder information

4) Please rate the annual report on the following characteristics:

(scale of 1-5, very poor, poor, fair, good, excellent)

1	2	3	4	5	Helping you understand CAE today
1	2	3	4	5	Helping you understand CAE's future
1	2	3	4	5	Appearance/design
1	2	3	4	5	Organization
1	2	3	4	5	Readability
1	2	3	4	5	Photography
1	2	3	4	5	Use of charts/graphs

5) Overall, how would you rate the 1998 annual report?

(scale of 1-5, very poor, poor, fair, good, excellent)

1 2 3 4 5

6) What information would you like to see included in future reports?

_____

_____

Thank you for your interest in the 1998 CAE annual report.
Please return this postage-paid card to us at your convenience.

03657043 -M5J2J1-BR01

CAE INC
PO BOX 14212 STN BRM B
TORONTO ON M7Y 2S1

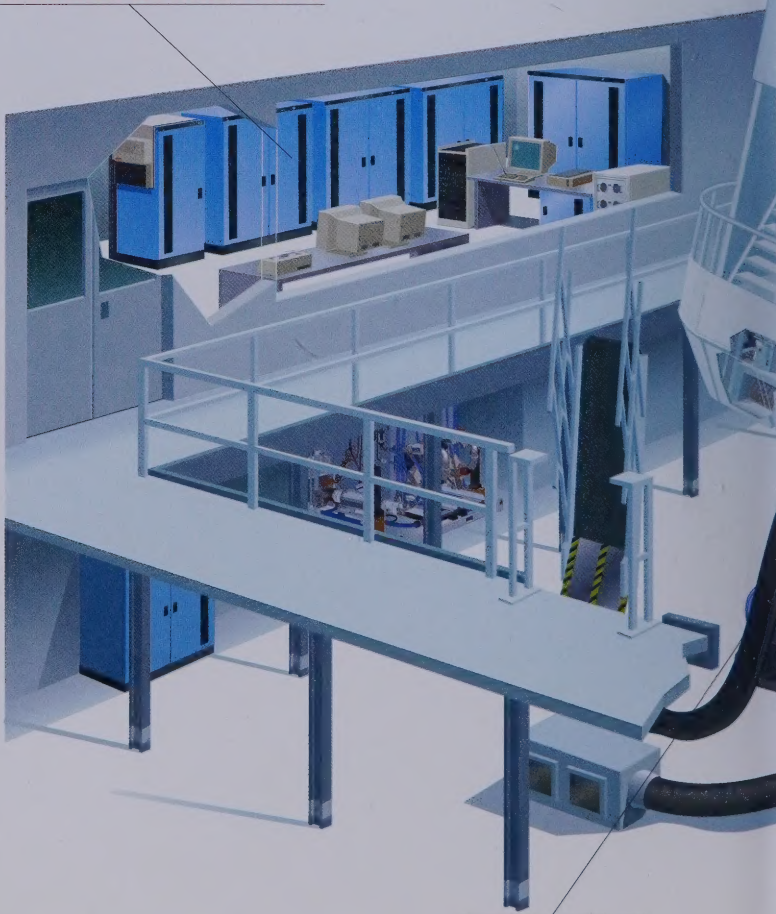

SIMULATION: THE INSIDE STORY

AVIONICS

BY DESIGNING AND MANUFACTURING PROPRIETARY CIRCUIT BOARDS, CAE PROVI ITS CUSTOMERS WITH AN INNOVATIVE, COST-EFFECTIVE AND HIGHLY RELIABLE OPT TO DRIVE EITHER REAL OR SIMULATED AIRCRAFT AVIONICS DISPLAYS.

COMPUTING POWER

THE LATEST GENERATION AIRCRAFT SIMULATORS REQUIRE POWERFUL HOST COMPUTERS. CAE'S COMPUTING SYSTEMS HAVE SUPERIOR INPUT/OUTPUT CAPABILITY AS WELL AS CENTRALIZED COMPUTING POWER TO MEET TRAINING REQUIREMENTS. THUS, THE CENTRALIZED HOST COMPUTER PROVIDES A SIMPLE AND ELEGANT ARCHITECTURE THAT ALLOWS AIRLINES AN EASY UPGRADE PATH FOR INCORPORATING FUTURE NEW AIRCRAFT SYSTEMS.



TRAINING ENVIRONMENT

CAE WAS THE FIRST TO POSITION THE INSTRUCTOR'S STATION DIRECTLY BEHIND THE PILOTS. OUR FORWARD-FACI CONFIGURATION INTEGRATES INSTRUCTORS INTO THE TRAINI ENVIRONMENT, ENABLING THEM TO BE MORE EFFECTIVE IN ASSESSING PILOT PROFICIENCY.

VISUAL SYSTEMS

A SIGNIFICANT ELEMENT THAT HELPS CREATE REALISTIC FLIGHT SIMULATION IS A BRIGHT, SHARP, DETAILED VISUAL SCENE. CAE'S MAXVUE PLUS™ VISUAL SYSTEM PROVIDES PILOTS WITH HIGH-RESOLUTION, FULLY-TEXTURED CUES FOR REALISTIC TAKE-OFF AND LANDING TRAINING. THE TIME BETWEEN INPUT TO THE VISUAL AND OUTPUT IS THE SHORTEST IN THE INDUSTRY – JUST 52 MILLISECONDS.

MOTION BASE

ONE OF THE KEYS FOR REALISTIC FLIGHT SIMULATION IS TO PROVIDE FIDELITY MOTION CUES IN ALL SIX AXES OF MOVEMENT TO PILOT CONTROL INPUT. CAE'S HYDROSTATIC ACTUATORS PROVIDE HIGHLY RESPONSIVE AND EXCEPTIONALLY SMOOTH MOTION CUES. WITH ONLY 12 MILLISECONDS BETWEEN COMMAND AND MOVEMENT, CAE OFFERS THE MOST RESPONSIVE SIMULATORS IN THE INDUSTRY.


THINKING
ADVANCED